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Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C.

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FEDERAL COMMUNICATIONS COMMISSION  
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In the Matter of )  
 )  
Price Cap Performance Review )  
for Local Exchange Carriers; )  
Treatment of Video Dialtone Service )  
Under Price Cap Regulation )

CC Docket No. 94-1

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COMMENTS OF  
THE CALIFORNIA CABLE TELEVISION ASSOCIATION  
IN THE THIRD FURTHER NOTICE OF PROPOSED RULEMAKING

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**COMMENTS OF THE CALIFORNIA CABLE TELEVISION ASSOCIATION**

The California Cable Television Association ("CCTA"),<sup>1/</sup> by its attorneys, hereby files these comments on the Third Further Notice of Proposed Rulemaking in the above-captioned proceeding<sup>2/</sup> regarding the treatment under price caps of local exchange carrier ("LEC") video dialtone services.

**INTRODUCTION AND SUMMARY**

In the Video Dialtone Reconsideration Order,<sup>3/</sup> the Commission emphasized that LECs offering video dialtone service have a strong incentive to engage in cross-subsidization and set predatorily low prices for video dialtone service by leveraging their monopoly power

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<sup>1/</sup> CCTA is a trade association representing cable television operators with over 400 cable television systems in California, including both small rural systems and national multiple system operators. CCTA's members are potential competitors of local telephone companies in the provision of video services to the public in California.

<sup>2/</sup> In the Matter of Price Cap Performance Review for Local Exchange Carriers: Treatment of Video Dialtone Services Under Price Cap Regulation, Second Report and Order and Third Further Notice of Proposed Rulemaking, CC Docket No. 94-1, FCC 95-394 (rel. Sept. 21, 1995) ("Second Report and Order" or "Third Further Notice").

<sup>3/</sup> In the Matter of Telephone Company-Cable Television Cross-Ownership Rules, Sections 63.54-63.58, Memorandum Opinion and Order on Reconsideration and Third Further Notice of Proposed Rulemaking, 10 FCC Rcd 244 (1994) ("Video Dialtone Reconsideration Order"), appeal pending sub nom., Mankato Citizens Telephone Company, No. 92-1404 (D.C. Cir. filed September 9, 1992).

in the local exchange telecommunications market.<sup>4/</sup> Consequently, the Commission asserted that it needed to strengthen existing safeguards against cross-subsidization through the adoption of rules specifically designed to identify and prevent the flow of subsidies from LEC telephony revenues to their video dialtone offerings.<sup>5/</sup>

In accordance with the Video Dialtone Reconsideration Order, the Commission has established several mechanisms designed to assist regulators in their efforts to minimize the risk of anticompetitive cross-subsidization, including cost tracking and reporting requirements.<sup>6/</sup> Most recently, it reaffirmed the tentative conclusion in the Video Dialtone Reconsideration Order that the video dialtone offerings of price cap LECs belong in a new,

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<sup>4/</sup> Id., 10 FCC Rcd at 344 ("[b]ecause video dialtone is an essential component of a multichannel video service that will compete directly with cable television operators and other multichannel video programming providers, LECs may have an incentive to understate the direct costs of the service in order to set unreasonably low prices and engage in cross-subsidization.").

<sup>5/</sup> Id., 10 FCC Rcd at 319-321.

<sup>6/</sup> On April 3, 1995, the Common Carrier Bureau issued RAO Letter 25, Responsible Accounting Officer Letter 25, DA 95-703 (rel. April 3, 1995) ("RAO Letter 25"), requiring LECs to set forth full video dialtone cost information to provide the Commission with both the information to assess the proposed deployment and with the basis to evaluate whether there is a need for permanent accounting and other rule changes to accommodate video dialtone. Not surprisingly, the LECs strongly opposed any implementation of RAO 25 Letter requirements. See, e.g., Application for Review of Bell Atlantic, RAO Letter 25, DA 95-703, at 3-8 (filed May 3, 1995).

The Commission also established a uniform data collection system for LECs offering video dialtone service designed to help protect telephone customers and cable operators from potential LEC anti-competitive conduct. See In the Matter of Reporting Requirements on Video Dialtone Costs and Jurisdictional Separations for Local Exchange Carriers Offering Video Dialtone Services, DA 95-2036, AAD No. 95-59, Memorandum Opinion and Order at ¶¶ 5, 52 (rel. Sept. 29, 1995) ("Video Dialtone Reporting Requirement Order"). The Video Dialtone Reporting Requirement Order enables the Commission to gather information to analyze the impact of video dialtone on LEC costs, local telephone rates, and the assignment of costs between the federal and state jurisdictions. Id. at ¶ 52.

separate price cap basket.<sup>71</sup> CCTA agrees that a separate basket will serve the Commission's objectives and should be established immediately by price cap LECs offering video dialtone.

While the purpose of establishing a separate video dialtone price cap basket was to deter LEC cross-subsidization, however, the Commission now advances a proposal that weakens the efficacy of this decision. By permitting LECs to postpone the segregation of video dialtone costs and revenues until dedicated video dialtone investment reaches a de minimis threshold, price-cap LECs can commingle video dialtone costs and revenues with those of telephony services for purposes of sharing and the low-end adjustment. Not only is there no sound necessity or efficiency basis for this proposal, it also offers price-cap LECs additional opportunities to engage in cross-subsidization and anticompetitive pricing of video dialtone service. Accordingly, the Commission should reject the de minimis threshold proposal and require price cap LECs immediately to segregate video dialtone costs from telephony costs.

In the alternative, should the Commission find it necessary to adopt some de minimis threshold before triggering the establishment of a separate price cap basket for video dialtone services, it should impose a truly de minimis threshold level based upon both wholly dedicated and shared video dialtone costs.

Finally, it should be stressed that the most important protection against improper cross-subsidization continues to be the proper allocation of video dialtone costs. As CCTA has previously observed, proper costing requires adherence to basic principles of cost-

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<sup>71</sup> Second Report and Order at ¶ 15.

causation.<sup>8/</sup> The Commission must determine "which costs are truly the consequences of a carrier's decision to provide video dialtone service"<sup>9/</sup> and then ensure that video dialtone rates recover all these costs. In the case of Pacific Bell ("Pacific" or the "Company"), the evidence is overwhelming that the construction and deployment of Pacific's new hybrid fiber-coaxial ("HFC") network is unnecessary for the continued provision of basic telephone service, and is instead being driven almost exclusively by Pacific's desire to enter the video market in California.<sup>10/</sup> CCTA is confident that a careful review of the LECs' cost studies in accordance with the principles of cost-causation will reveal a massive understatement of the costs attributable to telephony services. Only by setting the initial levels properly can price caps achieve its goals.

## **ARGUMENT**

### **I. THE PROPOSAL TO ADOPT A DE MINIMIS THRESHOLD THREATENS TO UNDERMINE THE EFFICACY OF MEASURES DESIGNED TO PREVENT ANTICOMPETITIVE CROSS-SUBSIDIZATION**

The Commission's decision to establish a separate video dialtone price cap basket represents a critical component of its effort to construct a video dialtone policy framework that deters cross-subsidization and anticompetitive predatory conduct. Yet, a price cap structure that permits LECs to commingle video dialtone service costs and revenues with the

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<sup>8/</sup> See, e.g., Video Dialtone Reconsideration Order, 10 FCC Rcd at 345-346.

<sup>9/</sup> Id., 10 FCC Rcd at 345.

<sup>10/</sup> See In the Matter of the Application of Pacific Bell, File Nos. W-P-C 6913-6916, CCTA Reply to Pacific Bell's Opposition to Petitions to Deny at 16-22 and Exhibit No. 3, Affidavit of Dr. Robert A. Mercer (filed March 11, 1994); see also Ex Parte letters from CCTA to Kathleen M.H. Wallman, File Nos. W-P-C 6913-6916 dated January 6, January 20, and April 11, 1995; CCTA Opposition to Pacific Bell's Petition for Expedited Waiver of Part 69 Rules, File No. CCB Pol 95-10, at 2-5, 8-12 and Exhibits A-E (filed Oct. 2, 1995).

costs and revenues attributable to telephone service is inherently flawed because it invites the very real dangers of regulatory gaming and cross-subsidization that the Commission sought to deter by establishing a separate basket for video dialtone in the first place.

As CCTA has observed in its previous filings in this docket, the sharing and low-end adjustment mechanisms in both the video dialtone and non-video dialtone price cap schemes, and the periodic reconsideration of the parameters of the price cap formulas (especially the productivity factor), can reintroduce elements of traditional cost-of-service regulation that give the LECs the incentive and ability to engage in cross-subsidization of competitive services through excessive rates for monopoly telephone services.<sup>11/</sup> The sharing and low-end adjustment mechanisms give LECs an incentive to "spend" otherwise shareable earnings from telephone services by reducing rates below-cost for competitive services. In addition, the periodic reconsideration of the price cap productivity factor for telephony services gives LECs the incentive to show lower earnings and higher costs so as to persuade regulators to adopt a lower productivity hurdle to apply to future rates.<sup>12/</sup>

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<sup>11/</sup> While the FCC has indicated that it tentatively believes that eliminating sharing and the low end adjustment may serve the public interest, this is not the price caps regime that LECs are operating under today. See In the Matter of Price Cap Performance Review for LECs, First Report and Order, CC Docket 94-1, 10 FCC Rcd 8961, 9035 (rel. April 7, 1995) ("LEC Price Cap Order").

<sup>12/</sup> Significantly, in Phase I of the California Public Utilities Commission's ("CPUC") review of its regulatory framework, Pacific proposed eliminating the inflation and productivity portion of the price cap formula that is used to adjust service prices each year. See "Pacific Telesis Earnings Decrease, in Line with Expectations," Business Wire (Oct. 18, 1995).

CCTA agrees that the Commission's decision to establish a separate video dialtone basket helps prevent regulatory gaming by price cap LECs offering video dialtone.<sup>13/</sup> Yet, postponing the segregation of video dialtone costs and revenues until video dialtone investment decreases a LEC's annual rate of return by 10 or 25 basis points, as proposed, revives and strengthens the incentives for such gaming. Thus, the LECs will have every incentive to avoid triggering the de minimis threshold level that will require them actually to utilize the separate video dialtone price cap basket, since cross-subsidization and anticompetitive pricing are much harder to detect when video dialtone costs and revenues are commingled with telephony costs and revenues. Indeed, there are numerous ways in which LECs can delay or postpone triggering the threshold and thus perpetuate a substantially heightened risk of cross-subsidization and predatory pricing.

**A. The De Minimis Threshold Proposal Contains No Benefits and Significantly Expands the Risk of LEC Cross-Subsidization**

In the Third Further Notice, the Commission has proposed that a de minimis threshold could be set at the amount of dedicated video dialtone investment that would reduce the LEC overall rate of return by 10 or 25 basis points.<sup>14/</sup> As an initial matter, this de minimis threshold proposal should be rejected because it is "de minimis" in name only. As demonstrated below, the threshold proposed affords a LEC the opportunity to commingle video dialtone and telephony costs within the same price cap basket for a significant period

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<sup>13/</sup> See Second Report and Order at ¶ 15.

<sup>14/</sup> See Third Further Notice at ¶ 40.



of time before it is finally required to segregate video dialtone into a separate price-cap basket.

If the Commission is committed to the development of a price cap plan for video dialtone service that truly minimizes the risks of cross-subsidization and anticompetitive behavior, it should avoid any delay in implementing the separation of video dialtone costs and revenues from telephony services. A threshold exemption for separating video dialtone costs and revenues from telephony services simply expands LEC opportunities to cross-subsidize and unnecessarily postpones the cost segregation which the Commission has already determined to be essential to promote fair competition and protect telephone ratepayers. Given that RAO Letter 25 and the Video Dialtone Reporting Requirement Order require LECs immediately to set forth and segregate video dialtone cost information in a straightforward manner, the time required to establish a separate video dialtone price cap basket from the outset would be insignificant. On the other hand, requiring LECs to establish a separate price basket only after a de minimis threshold is crossed would involve considerably greater effort because it would require LECs to extract the video dialtone data already commingled with other unrelated services and to readjust the telephony basket before establishing the separate video dialtone basket.<sup>15/</sup>

In addition, the establishment of the Commission's de minimis threshold proposal will create an additional and unnecessary layer of regulation. At a minimum, the establishment of a de minimis threshold will require the Commission to monitor the transfer of costs from

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<sup>15/</sup> Clearly, previously commingled video dialtone must be extracted from the telephony basket and removed to the separate video dialtone basket to avoid cross-subsidization.

basket to basket to ensure the completeness and accuracy of the separations process and to police disputes between parties concerning LEC manipulation of threshold levels. Requiring the immediate separation of video dialtone costs from telephony costs will remove these additional administrative burdens.

While the de minimis threshold proposal carries no administrative benefits, it significantly expands LEC cross-subsidization opportunities. The deficiencies inherent in the de minimis threshold proposal stem from the fact that the amount of dedicated video dialtone investment<sup>16/</sup> identified by most LECs is only a small fraction of their multi-billion dollar interstate rate bases. Because of the size of these rate bases, price cap LECs likely would need to expend millions of dollars in dedicated video dialtone investment in a single year in order to achieve a reduction of more than 10 or 25 basis points. Yet, most LECs are deploying hybrid broadband networks and proposing to identify only a small fraction of total network costs as dedicated video dialtone investment.<sup>17/</sup> Thus, a threshold keyed to dedicated video dialtone investment could permit the LECs to spend millions of dollars in direct video investment in multiple years and still potentially avoid triggering the threshold.

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<sup>16/</sup> Wholly dedicated video dialtone investment is defined to mean investment used exclusively for the provision of video dialtone service. Third Further Notice at ¶ 39. CCTA assumes, for purposes of these comments, that the Commission intends the term "dedicated video dialtone investment" (Id. at ¶ 40) to exclude shared investment. Shared video dialtone investments are those that are common, or are used jointly, to provide video dialtone and other LEC services. Id. at ¶ 39.

<sup>17/</sup> For example, Pacific alleges that only \$88 million in dedicated video dialtone will be spent to deploy a broadband platform to provide video dialtone service to 1.3 million potential homes in California. This \$88 million dedicated investment is but a small fraction of the \$1 billion investment that Pacific alleges it will make in constructing the facilities to pass these homes, and the \$16 billion estimate in network upgrades it expects to make through the "end of the decade." See infra note 19.

Indeed, there is a real possibility that some LECs showing low dedicated video dialtone investment amounts and high shared costs could construct most or all of their networks without segregating their video dialtone costs if the proposed de minimis threshold is adopted.<sup>18/</sup>

As an example, Pacific's applications to construct video dialtone in four service areas in California grossly underallocate the investment wholly dedicated to video dialtone.<sup>19/</sup> If the Commission were to accept Pacific's unreasonably low dedicated investment estimate of \$68 per home passed,<sup>20/</sup> Pacific would be able to avoid a separate video dialtone price cap basket for a long period of time.<sup>21/</sup> Thus, a threshold tied to dedicated video dialtone investment effectively encourages (and rewards) LECs if they label network costs as shared.

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<sup>18/</sup> Moreover, there is little likelihood that any calculation of the Commission's proposed de minimis threshold would stop there. By incorporating revenue, expense and accumulated depreciation effects in the Commission's proposed threshold calculation, the LECs could employ endless calculations designed to delay the segregation of video dialtone costs.

<sup>19/</sup> See In the Matter of the Application of Pacific Bell, File Nos. W-P-C 6913-6916, Order and Authorization at ¶¶ 48, 99 (rel. Aug. 15, 1995) ("Pacific Bell Order"). The Commission accepted Pacific's representation that the cost of deploying its video dialtone network would be approximately \$800 per home passed, \$68 of which is purported to be the cost for adding video dialtone service to the proposed HFC network. Thus, according to Pacific, multiplying this amount by the 1.3 million homes Pacific expects to pass, see id. at ¶ 7, results in total dedicated video dialtone network costs of approximately \$88 million. Considering Pacific's announcement that it intends to spend \$16 billion for network upgrades through the end of the century, see id., CCTA continues to find the allocation for wholly dedicated network costs to be incredible.

<sup>20/</sup> See Pacific Bell Order at ¶¶ 99-104. Pacific contended that the difference between its \$68 of dedicated investment per home passed and the \$150 - \$160 range proposed by NYNEX, US West, and Bell Atlantic can be explained by differences in architecture and capacity. Id.

<sup>21/</sup> Moreover, this period could be substantially longer than that implicated other LECs that have recorded much higher levels of dedicated investment to video dialtone.

In addition, price cap LECs also may attempt to avoid the de minimis threshold level by altering their network construction and deployment schedules. For instance, the Commission granted Pacific's applications to construct, operate and own video dialtone systems in four areas within its California service territory. The Commission's approval of Pacific's applications was premised upon Pacific's representations that it would provide hundreds of channels of analog and digital capacity over a HFC video dialtone network.<sup>22/</sup> Pacific recently announced that it will speed deployment of its HFC network in Northern California and will significantly reduce HFC construction in Southern California (in three of the four service areas it has received Commission approval for wireline construction) where it has acquired a wireless cable company.<sup>23/</sup> Pacific's selective deployment of video dialtone wireline systems in Northern California means that it will only incur approximately \$33 million in wholly dedicated video dialtone investment when fully deployed.<sup>24/</sup> Accordingly, Pacific may be entitled to deploy all or a substantial portion of its new HFC network in Northern California without triggering the de minimis threshold.<sup>25/</sup> CCTA previously has demonstrated that the selective deployment is discriminatory and

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<sup>22/</sup> Id. at ¶ 10.

<sup>23/</sup> See "Pacific Telesis Telco to Offer Wireless Cable Television," Press Release (July 25, 1995).

<sup>24/</sup> The wholly dedicated investment may be calculated as follows: 490,000 homes passed (Pacific Bell Order at ¶ 7, n.15) x \$68 (purported wholly dedicated video dialtone investment) (Id. at ¶ 99) = \$33 million. CCTA continues to believe that this amount is wholly unreasonable.

<sup>25/</sup> Pacific's ability to delay cost segregation would be further strengthened if the threshold level trigger is based only on whether a LEC's annual, rather than cumulative, video dialtone investment lowers its overall rate of return in a particular year.

anticompetitive for numerous reasons.<sup>26/</sup> The de minimis proposal would aggravate these concerns by permitting Pacific to indefinitely postpone the segregation of video dialtone costs. As there is no countervailing policy benefit to this postponement, the Commission should not permit it.<sup>27/</sup>

**B. Any De Minimis Threshold Utilized by the Commission Must Minimize LEC Cross-Subsidization Opportunities**

The establishment of a de minimis exemption to the separation of video dialtone costs and revenues is likely to expand the risks of predatory pricing and anticompetitive discrimination in the video marketplace. Should the Commission choose to establish a de minimis test, however, it should establish a threshold which reduces the ability and incentives for LECs to leverage their market power in telecommunications to gain an unfair competitive advantage in video services.

As demonstrated above, a de minimis threshold based upon a 10-25 basis point reduction in a LEC's rate of return is too susceptible to manipulation and regulatory gaming. If the Commission insists on establishing a rate of return based de minimis threshold, it must

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<sup>26/</sup> See, e.g., CCTA Opposition to Pacific Bell's Petition for Expedited Waiver of Part 69 Rules, File No. CCB Pol 95-10, at 8-12 (filed Oct. 2, 1995); CCTA Petition to Deny Application of Pacific Telesis Enterprises to Acquire Multipoint Distribution Service Stations from CC Wireless, Inc., File No. 51052-CM-TC(2)-95 (filed Oct. 11, 1995). See also U.S. v. Western Electronic Co., Civ. Action No. 82-0192, CCTA Opposition Memorandum to Motion of Pacific Telesis Group for Waiver for Additional InterLATA Delivery Authority (Multichannel Multipoint Distribution Service), (filed Sept. 5, 1995).

<sup>27/</sup> Indeed, price cap LECs could also treat the Third Further Notice's dedicated video dialtone investment as an annual, rather than cumulative, amount. Third Further Notice at ¶ 40. This interpretation could allow price cap LECs to keep video dialtone investment amounts steady over a period of time to avoid the de minimis threshold level for an indefinite period of time.

be triggered by a significantly smaller basis point reduction than was proposed in the Third Further Notice to ensure that it is truly de minimis.<sup>28/</sup> The LECs should not have the opportunity to commingle millions of dollars of video dialtone costs with telephony revenues prior to the triggering of the threshold, the likely result of the tentative proposal set forth in the Third Further Notice.<sup>29/</sup>

Moreover, the de minimis threshold level must be based upon both dedicated and shared video dialtone investment amounts. There is simply no reason to exclude shared costs from the amount of investment to trigger the threshold. As demonstrated above, the exclusion of shared costs will aggravate LEC incentives to misallocate direct video dialtone costs as shared costs, and enhance cross-subsidization risks in connection with dual-use broadband networks that rely heavily on shared costs. In addition, the exclusion also would discourage LECs from promptly segregating and assigning between the video dialtone and telephony baskets those costs that are properly identified as shared.

The Commission has suggested basing the de minimis threshold on the data submitted by carriers under RAO Letter 25.<sup>30/</sup> Essential to the success of any threshold proposal is the assumption that LECs will comply with the provisions of RAO Letter 25. As with any

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<sup>28/</sup> Moreover, if a rate of return based threshold is utilized, it should be triggered if either the annual or cumulative amount of LEC video dialtone investment triggers the basis point reduction in a particular year.

<sup>29/</sup> Obviously, any amount of video dialtone investment permitted to be commingled with LEC telephony earnings must be removed to, and included in, the video dialtone price cap basket once the threshold is triggered. The problem, however, is that the threshold expands LEC opportunities to shelter video dialtone costs in the telephony side of its business, which may never be identified and properly allocated even after the threshold is triggered.

<sup>30/</sup> Third Further Notice at ¶ 39.

cost accounting mechanism, the underlying function codes, continuing property records, and accounting classifications can be a staging point for cost manipulation, which could affect the point at which the threshold is triggered. The proposal to tie the video dialtone price cap basket threshold to RAO Letter 25 data once again underlines the importance of mandating Commission, independent, and internal LEC audits to assure ongoing telephone company compliance with the Commission's cost accounting requirements. Likewise, publicly available and verifiable data is critical.<sup>31/</sup>

For example, LECs should be required to maintain and include subsidiary records that contain and report the costs for retirements of transmission facilities within the geographic area in which the service will be provided.<sup>32/</sup> Indeed, the proper attribution of early retirements is critical to the establishment of any de minimis threshold requirement. For example, Pacific has proposed prematurely to accelerate depreciation of a substantial amount of its current network equipment.<sup>33/</sup> This retirement is driven by its plans to provide video dialtone services over the HFC network that Pacific will provide. While Pacific has characterized its alleged \$16 billion investment in the HFC network chiefly as an upgrade of

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<sup>31/</sup> See Section II infra.

<sup>32/</sup> See RAO Letter 25 at 3. Indeed, this question of non-compliance is not hypothetical. At least one LEC has expressed a reluctance to conform its accounting records to the requirements of RAO Letter 25. See In the Matter of The Southern New England Telephone Company Accounting and Cost Allocation Plan, Transmittal No. 641, DA 95-2083 at 19 (rel. Sept. 29, 1995) (SNET was ordered to maintain subsidiary records on plant assets replaced as a result of the deployment of its hybrid-fiber coaxial network).

<sup>33/</sup> See, L. Cauley, "Pacific Telesis Plan a Charge of \$3.3 Billion," Wall Street Journal at B3 (Sept. 8, 1995).

its telephone network and presented the video components as merely incremental to its telephony costs, the facts reveal otherwise.

As CCTA previously has explained to the Commission,<sup>34/</sup> Pacific's recent announcements of its redefined focus on constructing and deploying its HFC network only where such facilities are needed to enable Pacific to provide wired video competition, while utilizing wireless digital television to deliver programming in other service areas,<sup>35/</sup> makes plain that the driver of the wireline HFC network is Pacific's desire to be in the video business. Accordingly, Pacific and other price cap LECs who are proposing similar network "upgrades" must include early retirement amounts for purposes of the de minimis threshold calculation. Absent compliance with RAO Letter 25 in its entirety, any de minimis threshold plan becomes unworkable as the Commission and interested parties may not receive any reassurance that the LECs are properly recording the full and fair costs of video dialtone entry.

## **II. PROPER COSTING AND PRICING OF VIDEO DIALTONE SERVICE REQUIRE STRICT ADHERENCE TO PRINCIPLES OF COST CAUSATION**

In addition to the de minimis threshold proposal, the Commission has requested comment on appropriate procedures for allocating costs to a separate video dialtone basket once the relevant threshold has been exceeded. In this regard, CCTA asserts that careful Commission review of the LECs' video dialtone cost studies — with input from all interested parties — remains the critical factor in the development of proper costing and pricing in

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<sup>34/</sup> See CCTA Opposition to Pacific Bell's Petition for Expedited Waiver of Part 69 Rules, File No. CCB Pol 95-10, at 8-12 (filed Oct. 2, 1995).

<sup>35/</sup> Id.



order to protect telephone ratepayers from anticompetitive behavior.<sup>36/</sup> If the Commission is to promote its overarching objective — ensuring that video dialtone costs are not recovered through charges for other interstate access services — it must commit to a diligent and thorough examination of video dialtone costs and the economically correct assignment of the underlying broadband network costs to the video service category. Thus, in setting proper video dialtone rates that cover direct costs and allocated common and overhead costs, as the Commission required in the Video Dialtone Reconsideration Order,<sup>37/</sup> the investigation into any determination of video dialtone costing must be both far-reaching and fundamental.

Proper video dialtone pricing and costing require the Commission to determine "which costs are truly the consequences of a carrier's decision to provide video dialtone service"<sup>38/</sup> and then ensure that video dialtone rates recover all these costs. Such an investigation requires the Commission to confront fundamental questions of whether the LECs are building their broadband networks to provide video services, with telephony services being "incremental" add-ons to services requiring broadband capacity, or whether

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<sup>36/</sup> Significantly, in a draft decision of the California Public Utilities Commission ("CPUC") relating to cost methodology principles and cost studies for Open Access and Network Architecture Development, the CPUC has stated that it "will limit access to the TSLRIC studies covering HFC services other than telephony and the costs shared between telephony and video." Docket R.93-04-003 (filed April 7, 1993), Docket 1.93-04-002 (filed April 7, 1993), Draft Decision at 42. Under this draft decision, therefore, independent parties and the public will not be permitted to review these critical cost studies, Id. While the FCC anticipated that state commissions would engage in full review of relevant video costs, Video Dialtone Reconsideration Order, 10 FCC Rcd at 334, it now seems that there will not necessarily be the anticipated heavy, independent scrutiny of this crucial data at the state level. As such, it is incumbent upon the Commission to ensure that all relevant cost studies are produced and analyzed fully by it and interested parties.

<sup>37/</sup> Video Dialtone Reconsideration Order, 109 FCC Rcd at 339-346.

<sup>38/</sup> Id., 10 FCC Rcd at 345.

the LECs are correct in asserting that their new networks are being built to provide improved telephony services.

As CCTA has previously maintained,<sup>39/</sup> the Commission should conclude immediately that for many proposed integrated networks, especially those premised upon the hybrid fiber-coaxial cable architecture, video services should be treated as the "base" and telephony services as the "increment" in any cost allocation process. This approach properly implements the principles of the Total Service Long-Run Incremental Cost ("TSLRIC") methodology that CCTA advocated in previous comments in this proceeding.<sup>40/</sup> These cost allocation issues must be resolved properly, and interested parties, the public, and the Commission must have the opportunity to scrutinize the LECs' cost studies in detail so that the Commission can require that price floors for video dialtone rates are set to recover all costs incurred as a result of the LECs' decision to offer video dialtone service.

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<sup>39/</sup> See, e.g., In the Matter of Price Cap Performance Review for Local Exchange Carriers; Treatment of Video Dialtone Service Under Price Cap Regulation, CC Docket No. 94-1, CCTA Comments in the Further Notice of Proposed Rulemaking (filed April 17, 1995) ("CCTA VDT Price Cap Comments"); CCTA Reply Comments in the Further Notice of Proposed Rulemaking (filed May 17, 1995) ("CCTA VDT Price Cap Reply Comments").

<sup>40/</sup> See CCTA VDT Price Cap Comments at 11-12; CCTA VDT Price Cap Reply Comments at 17-19. TSLRIC is a methodology for calculating forward-looking long-run costs for an increment of demand equal to the entire video dialtone service. Proper application of TSLRIC principles requires that all costs incurred because of the decision to offer a particular service be assigned to that service. Thus, TSLRIC would require many LECs to designate the costs of their broadband networks as costs of video dialtone service rather than narrowband telephony services. Depending on individual LEC circumstances, it may be appropriate for the costs of the new broadband networks to be treated as shared costs of video dialtone and other broadband services. This would not mean, however, that basic telephone services that require only narrowband capabilities should be assigned any share of the new broadband network costs.

CCTA is concerned that the Third Further Notice could be understood to suggest that the Commission ignore the principles of cost causation for purposes of allocating costs to the video dialtone basket through the use of a mechanism that is different than that required to set video dialtone rates.<sup>41/</sup> Consequently, CCTA urges the Commission to ensure that it does not lose sight of the need to focus intently on the LECs' cost studies in support of their proposed video dialtone service offerings, whether they be for the setting of rates or for the determination of any allocation of costs to the separate video dialtone basket. Accordingly, the Commission should require all LECs planning to offer video dialtone service to prepare and submit complete and fully documented cost studies showing not only their estimated incremental costs for video dialtone, but also the incremental costs for telephony services, the joint and common costs for video and telephony services and the method for allocating joint and common costs between these service categories.<sup>42/</sup> The consistent use of these studies for both the separate video dialtone basket and rate-setting purposes is in the public interest because it will decrease the ability of LECs to use their monopoly power in the telephone market to gain an unfair competitive advantage in the video marketplace at the expense of their telephone ratepayers.

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<sup>41/</sup> Third Further Notice at ¶ 41.

<sup>42/</sup> In this regard, CCTA continues to urge that the Bureau adopt, as soon as possible, a detailed tariff review plan for the LECs to follow as they propose video dialtone service deployment. As with the Tariff Review Plan Order that was adopted for the virtual collocation tariffs, In the Matter of Commission Requirements for Cost Support Material To Be Filed With Virtual Collocation Tariffs for Special Access and Switched Transport, 9 FCC Rcd 5679 (1994), such a plan would allow the Commission and interested parties to examine relevant rate structures and rate levels effectively and efficiently.

## CONCLUSION

For the reasons set forth herein, the Commission should decline to adopt a de minimis threshold and require LECs to allocate video dialtone costs through strict adherence to principles of cost causation.

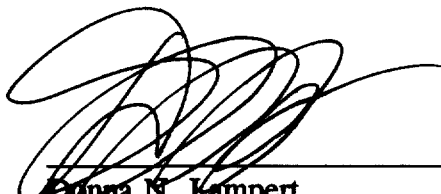
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October 27, 1995

## **CERTIFICATE OF SERVICE**

I, Cheryl S. Flood, a secretary of the law firm of Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, P.C., hereby certify that on this 27th day of October, 1995, I caused a copy of the foregoing "Comments of The California Cable Television Association in the Third Further Notice of Proposed Rulemaking" to be served on the persons specified below by first-class mail, postage prepaid, or by hand delivery\*:

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